district court dismissed petitioner's complaint, and the court of appeals affirmed.

The crucial facts, as the court of appeals stated (Pet. App. 3), are "for the most part undisputed," and petitioner expressly has accepted the trial court's findings (Reply Memorandum, p. 3). Petitioner, "an experienced and successful investor," in January 1959 purchased 5100 shares of Fashion Park stock at $13.50 per share (Pet. App. 4). On November 11, 1960, he authorized his broker to sell the stock at not less than $18 a share net to him (*ibid.*). Petitioner's broker called respondent H. Hentz & Co. ("Hentz"), another broker, and offered the shares at $20; after negotiation, the stock was sold on November 17 at $18.50 per share (Pet. App. 5). Respondent Lerner, a member of the board of directors of Fashion Park, purchased 4300 of these shares; the remaining 800 were purchased by a partner in Hentz and by another partnership in which this partner was interested (*ibid.*).

None of the respondents, who include Hentz, disclosed at the time of the purchase either (1) that Lerner was a director of Fashion Park or (2) that the Fashion Park board of directors, at a meeting on November 4, 1960, which Lerner had attended, had decided to seek to sell or merge the company (Pet. App. 5–6). The board so decided following discussion with a union manager who, after threatening to withdraw a substantial number of employees from Fashion Park if he could induce another firm to settle in the same city, urged the board to consider selling the company; and, without disclosing the identity of the

potential purchaser or possible sale terms, stated that he knew of someone who might be interested in buying the company (Pet. App. 3–4).

Less than one week after respondents' purchase of petitioner's stock, negotiations were begun looking toward the acquisition of Fashion Park by Hat Corporation of America, the prospective purchaser which the union manager had by then identified (Pet. App. 4). In February 1961 a formal purchase agreement was executed, under which the purchaser would offer minority shareholders of Fashion Park $50 per share (*ibid.*). Petitioner's asserted damages are based upon the difference between this price and the $18.50 at which he sold to respondents (Pet. App. 5).

The court of appeals held that a purchaser of securities may violate Rule 10b–5 while maintaining complete silence (Pet. App. 7–8); but that in order to recover damages for such violation the seller must establish (1) that knowledge of the undisclosed facts would have "influenced [him] to act differently" (referred to by the court as "reliance") (Pet. App. 11), and (2) that "a reasonable investor" would have been influenced by the disclosure (referred to by the court as "materiality") (Pet. App. 14, 10, 12). The court of appeals upheld, as not clearly erroneous, the conclusions of the district court (1) that petitioner would have sold his stock even if he had known that the purchaser was a director of Fashion Park, *i.e.*, that there was no "reliance" upon that nondisclosure (Pet. App. 12); and (2) "that the prospects for 'a sale of Fashion Park' and for a sale at a price 'profitable to shareholders,' insofar as Lerner and the other * * *

[respondents] apprehended them to be at the time they purchased * * * [petitioner's] stock, were too remote to have influenced the conduct of a reasonable investor", *i.e.*, "that adoption of the November 4, 1960 resolution and the setting in which it occurred, were not material facts that should have been disclosed to * * * [petitioner]" (Pet. App. 13–14).[3]

DISCUSSION

This case involves the duty of disclosure which Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 of the Rules and Regulations of the Securities and Exchange Commission thereunder impose upon corporate insiders when they deal in their corporation's securities. That Section makes it unlawful for any person to employ, in connection with the purchase or sale of any security, "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules. Rule 10b–5, insofar as here pertinent, makes it unlawful, in connection with such purchase or sale, for any person "to employ any device, scheme, or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." The issues here involve (1) the scope

[3] The court of appeals noted that respondent Lerner had "disposed of part or all of his interest in 3137 of his 4300 shares at an average profit of only about $1 per share" within two weeks of his purchase from petitioner (Pet. App. 13). The record shows, however, that 2000 of these 3137 shares were sold to an investment company in which Lerner was the largest stockholder and that others were sold to Lerner's attorney, to employees of Lerner's own brokerage firm and to several customers of that firm (R. 210a–214a).

of the disclosure which these provisions require insiders to make before buying from minority stockholders, and (2) the extent to which the sellers, in order to recover damages resulting from the statutory violation, must show a causal connection between the non-disclosure and their decision to sell.

The issues have many ramifications, and they may arise in a wide variety of factual situations. They have become more important in recent years, since Section 10(b) and Rule 10b–5 have been relied on with increasing frequency by the Commission to prevent deceptive activities by purchasers of securities and by private parties to secure redress for such activities.[3] This Court has not yet interpreted these provisions, and a decision by it would provide helpful guideposts in the development of this important area of the law. In the present case, however, we believe that the court of appeals correctly decided the most important interpretive question, and that the case as presented to this Court primarily involves the determination of factual questions. Although the Commission believes that certain rulings of the court of appeals are erroneous, it does not believe that such rulings, if allowed to stand, would have a sufficiently significant impact upon the administration of the Securities Exchange Act to warrant our urging the Court to hear the case.

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[3] See Fleischer, "*Federal Corporation Law*": *An Assessment*, 78 Harv. L. Rev. 1146, 1160 (1965). As to the importance of private actions as a necessary supplement to the Commission's enforcement activities, cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432.

1. The Commission believes that Rule 10b–5 requires a corporate insider, before he may purchase stock in his corporation (whether directly from the seller, or indirectly on a securities exchange or in the over-the-counter market), to disclose to the seller all information he has acquired as an insider that would be material to the seller in the sense that it might reasonably be expected to affect the investment judgment of the seller. We do not think that the court of appeals disagreed with this standard. For the court quoted with approval (Pet. App. 6–7) the following statement of the "general principles governing suits such as this" as set forth in the leading case of *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 828–829 (D. Del.), affirmed, 235 F. 2d 369 (C.A. 3):

> It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers.

Most importantly, the court held (Pet. App. 7–8) that such a duty of disclosure exists even though there is "no significant communication bearing upon value by buyer to seller except for offer, counteroffer, acceptance, or rejection." The court thus ruled that Rule 10b–5 requires a buyer to disclose material facts to a seller even though the transaction is consummated in a securities market without any direct communication between the parties; and that the buyer's duty of disclosure is not limited to situations where he

either makes a false statement or fails to disclose information which is necessary to make his statements not misleading. This ruling was plainly correct, and there is no occasion for further review thereof.

2. The point previously discussed involves the definition of the statutory violation—*i.e.*, the circumstances under which a corporate insider violates Section 10(b) and Rule 10b-5 by non-disclosure in connection with purchasing securities of his corporation from the public. Once such a violation is established, however, there is the further question of what causal connection the seller must show between the violation and his decision to sell in order to recover damages based on such violation.

At common law, neither a buyer nor a seller could recover from the other on a claim of fraud and deceit unless he could show not only that the other had made a materially false statement, but also that he had relied upon such statement to his detriment—*i.e.*, that the misrepresentation influenced him to enter into the transaction. See Prosser, *Handbook of the Law of Tort* (2d ed.) 189. Framing the test in terms of "reliance," however, is not particularly helpful when dealing with a case of complete non-disclosure. For it is difficult to see how a seller fairly can be said to have "relied" upon something he never even knew about, and this analysis leads to such confusing concepts (Pet. App. 12) as "the negative of the fact undisclosed." The appropriate inquiry, we believe, is whether the non-disclosure by the buyer caused injury to the seller.

The court of appeals enunciated the test as "whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact" (Pet. App. 11). In a case where the transaction was personally negotiated between the parties, this may be an appropriate basis for determining whether the seller was injured by the non-disclosure. But it would seem too restrictive a standard in situations where the element of personal negotiation was lacking and the purchases were routine transactions on a securities exchange or in the over-the-counter market. If, for example, an insider, upon receiving information which, if made public, foreseeably would cause the market price of his company's stock to double, buys such stock before the information is disclosed, those who sell to him at the lower price are damaged, even though they still might have sold had the information been public. See, *e.g.*, *Cady, Roberts & Co.*, 40 S.E.C. 907. For in that case they would have received twice as much. In any realistic sense, therefore, they were injured by the buyer's non-disclosure, and should be permitted to recover.

It is unclear whether the standard which the court of appeals announced would permit a seller to recover in such circumstances. On the one hand, since the seller still might have sold even if he had the information, he might not come within the test that he must "have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact." On the other hand, the court might give the words "act differently" a broad meaning and hold that they comprehend selling at a different price.

With the precise scope of the decision below on this point thus unclear, there is no occasion for the Court to decide the question in this case—particularly since the petition does not appear to raise it.

3. Finally, we believe that the court of appeals erred in evaluating the separate effect of each non-disclosure, rather than evaluating their combined and cumulative impact. Viewed separately, perhaps neither the fact that a director wished to make a substantial purchase of Fashion Park stock nor the fact that the board of directors had resolved to attempt to sell or merge the company would have led the petitioner to refrain from selling at $18.50 a share. It might well be, however, that a stockholder would have sold his stock at a given price had he known that the purchaser was a director but not if he also had known that the board of directors had recently decided to attempt to sell or merge the company. Similarly, while the board's decision might not of itself have seemed important to an investor in deciding whether to sell his stock at the going price, it could have become important when coupled with the knowledge that one of the directors was interested in adding $80,000 worth of the company's stock to his holding. Taken in combination, therefore, these two facts might suggest to an investor—and particularly to a sophisticated investor such as the petitioner—that the director knew something more which, in his judgment as an insider, made likely an increase in the price of the stock.

We thus conclude that the court of appeals here improperly applied the governing standard for determining whether the non-disclosures were ma-

terial and injured the seller. But we do not believe that such error, if allowed to stand, would so significantly weaken the effectiveness of private damage actions as a method of enforcing Rule 10b-5 as to require review by this Court. The question turns primarily upon the facts of this particular case, and it may be that, even if the court had considered the cumulative effect of the two non-disclosures, it would have reached the same result. In any event, the petition does not appear to present this question.

Respectfully submitted.

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AUGUST 1965.

APPENDIX

Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b–5, 17 CFR 240.10b–5, promulgated by the Commission thereunder, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme, or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

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